

Message Text

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SP-02 LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-07

CEA-01 AGRE-00 /089 W

-----092357 112143Z /23

R 110730Z JUL 78

FM AMEMBASSY KATHMANDU

TO SECSTATE WASHDC 2548

INFO AMEMBASSY NEW DELHI

LIMITED OFFICIAL USE SECTION 1 OF 4 KATHMANDU 3528

E.O. 11652: N/A

TAGS: EFIN, EAID, NP

SUBJECT: GON BUDGET FOR 1978/79

REF: 77 KATHMANDU 2782

1. BEGIN LOU. SUMMARY AND INTRODUCTION: GON BUDGET ESTIMATES FOR 1978/79 (JULY 78-JULY 79) CALL FOR TOTAL EXPENDITURES OF RS. 3752.8 MILLION (\$313 MIL ION), A 32 PERCENT INCREASE OVER THE REVISED ESTIMATES FOR 1977/78. OF THIS AMOUNT RS 2647.9 MILLION OR 71 PERCENT IS CLASSIFIED AS DEVELOPMENT EXPENDITURES. GOVERNMENT REVENUES ARE PROJECTED TO RISE 28 PERCENT TO RS 2025.6 MILLION WITH THE DEFICIT TO BE FINANCED THROUGH FOREIGN AID (LOANS AND GRANTS TOTALING RS 1523.3 MILLION) AND INTERNAL BORROWING (RS 200 MILLION), LEAVING RS 3.9 MILLION AS YET UNCOVERED. THE BUDGET APPEARS OVERLY OPTIMISTIC ON THE DEVELOPMENT EXPENDITURE SIDE, WHERE SUBSTANTIAL INCREASES ARE PROJECTED IN KEY SECTORS SUCH AS AGRICULTURE WHICH HAD MAJOR SHORTFALL THE PREVIOUS YEAR. AT THE SAME TIME IT STRIKES US AS UNREALISTIC IN ITS FINANCING PROJECTIONS, BOTNFON FOREIGN AID WHERE DISPERSEMENT

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WILL BE BIGGEST PROBLEM AND ON INTERNAL REVENUE, WHERE GOVERNMENT SIGHTS HAVE BEEN SET MUCH HIGHER THAN PAST PERFORMANCE APPEARS TO WARRANT. IN SHORT, IT APPEARS INEVITABLE THAT THERE WILL BE MAJOR BUDGET ADJUSTMENT AS THE YEAR UNFOLDS. END SUMMARY.

2. BEGIN UNCLASSIFIED. ON JULY 6 BHEKH BAHADUR THAPA,

MINISTER OF FINANCE PRESENTED GON BUDGET ESTIMATES FOR 1978/79
TO RASTRIYA PANCHAYAT. THE FOLLOWING TABLE
GIVES BUDGET HIGHLIGHTS AS COMPARED TO THE PREVIOUS TWO YEARS
(ALL FIGURES IN THIS AND SUBSEQUENT TABLES ARE IN MILLIONSO
OF RUPEES
; TOTALS MAY NOT CHECK DUE TO ROUNDING);

	1976/77	1977/78	1978/79	
	(ACTUAL)	J (REVISED ESTIMATES)	(ESTIMATES)	
EXPENDITURES	2330.4	2850.8	#3	3752.8
REGULAR	(832.1)	(918.6)		(1104.
DEVELOPMENT	(1498.3)	(1932.2)		(2647.9)
FINANCING				
REVENUE	(1322.9)	(1580.6)		(2;5.6)
FOREIGN AID	(556.9)	(963.4)		(1523.3)
INTENAL				
BORROWING	300.0	240.0	8	200.0
DEFICIT	150.6	66.8		3.9

3. ON THE EXPENDITURE SIDE, THE BUDGET CONTINUES THE PATTERN
OF THE LAST FEW YEARS OF PUTTING MAJOR EMPHASIS ON THE
DEVELOPMENT SECTOR, WITH A PROPOSED INCREASE OF 37 PERCENT
IN THESE EXPENDITURES AS COMPARED TO ONLY 20 PERCENT FOR
CATEGORIES FALLING UNDER THE REGULAR BUDGET. USTHIS INCREASE
REFLECTS NOT ONLY THE NEEDS OF THE COUNTRY BUT ALSO AN
APPARENT IMPROVEMENT IN ABSORPTIVE CAPACITY. THE LATTER
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POINT WAS SPECIFICALLY HIGHLIGHTED BY THAPA WHO CITED THE
MARKED IMPROVEMENT IN 77/78 IN DEVELOPMENT EXPENDITURES
ACTUALLY COMING UP TO THE ORGINAL BUDGET PROJECTIONS.
CONTRARY TO THE
YATTERN OF THE PREVIOUS THREE YEARS WHICH
HAS SEEN DEVELOPMENT OUTLAYS FALL SOME 15 PERCENT (16
PERCENT IN 1976/77) SHORT OF PROJECTIONS, THAPA PREDICTED
FINAL 1977/78 FIGURES WILL SHOW THESE EXPENDITURES
AT 90 PERCENT OF THE TARGETED FIGURE.

4. AS FOR THE DIRECTION OF DEVELOPMENT EXPENDITUREY, THE
FOLLOWING TABLE GIVES FIGURES BY K
JOR CATEGORIES WITH
COMPARISONS FOR THE TWO PREVIOUS YEARS:

	1976/77	1977/78	1978/79	
	(ACTUAL)	(REVISED ESTIMATES)	(ESTIMATES)	
ECONOMIC SERVICES	1033.4	1415.1		1988.5
AGRICULTURE	(340.6)	(374.9)		(648.7)
FORESTS	(44.8)	(55.3)		(103.7)
INDUSTRY &				
MINING	(149.4)	(104.6)		(193.0)

POWER	(48.8)	(329.3)	(331.9)
TRANSPORT &			
COMMUNICATIONS	(435.9)	(536.6)	(682.3)
OTHER	(13.9)	(14.4)	(28.9)
SOCIAL SERVICES	419.9	478.7	608.4
EDUCATION	(185.6)	(194.5)	(239.1)
HEALTH	(92.6)	(102.3)	(123.9)
DRINKING WATER	(61.2)	(70.3)	(85.1)
PANCHAYAT	(55.5)	(87.5)	(121.6)
OTHER	(25.0)	(24.1)	(38.7)
ECONOMIC ADMIN			
AND MISC.	44.8	38.8	50.7
GRAND DOTAL	1498.3	1923.2	2647.9

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5. THESE FIGURES ARE INTERESTING IN SEVERAL RESPECTS.
(A) A COMPARISON OF THE REVISED ESTIMATES FOR 1977/78 WITH THE ORIGINAL PROJECTIONS (REFTEL) TENDS TO UNDERCUT THE MINISZER'S POINT ON ABSORPTIVE CAPACITY. OVERALL THE RECORD IS NOT BAD BUT IN SPECIFIC CATEGORIES IT IS MOST UNEVEN. IN CRITICAL AREAS OF AGRICULTURE, FORESTRY AND INDUSTRY AND MINING THE SHORTFALLS WERE RESPECTIVELY 29.7, 40.2 AND 31.4 PERCENT. ON THE OTHER HAND THE INFRASTRUCTURE SECTORS OF POWER AND TRANSPORT AND COMMUNICATIONS, WHICH ARE SUPPOSED TO BE DE-EMPHASIZED UNDER CURRENT DEVELOPMENT PLAN, EXCEEDED THEIR PROJECTIONS BY PERCENTAGES OF 18.6 AND 7.0 PERCENT RESPECTIVELY. IN SHORT, ABSORPTIVE CAPACITY--OR, TO PUT IT ANOTHER WAY, THE ABILITY TO MEET DEVELOPMENT GOALS--REMAINS A PROBLEM.

(B) THE FIGURES DO REFLECT A MAJOR EFFORT TO CATCH UP IN THOSE AREAS WHERE THE COUNTRY HAS BEEN LAGGING BEHIND-- I.E. AGRICULTURE, FORESTS AND INDUSTRY. IN THESE THREE CATEGORIES ALONE THERE IS A PROJECTED INCREASE OF 77 PERCENT OVER THE ESTIMATED EXPENDITURES THIS FISCAL YEAR. IF THIS GOAL CAN BE MET THE IMPACT SHOULD BE SUBSTANTIAL.
(C) THE MINISTER EMPHASIZES AN EMPHASIS ON EFFORTS TO HELP THOSE LIMITED OFFICIAL USE

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IN RURAL AREAS--WHAT WE MIGHT TERM A RESPONSE TO BASIC HUMAN NEEDS. IN ADDITION TO THE FIGURES FOR AGRICULTURE AND FORESTS, THIS EMPHASIS IS REFLECTED IN INCREASES FOR HEALTH, DRINKING WATER SYSTEMS AND THE PANCHAYATS. A 56.9 PERCENT INCREASE IS PROJECTED IN THESE SECTORS. ON THE OTHER HAND, DISTRIBUTION OF DEVELOPMENT FUNDS IS WEIGHTED VERY HEAVILY (42 PERCENT) IN FAVOR OF THE MOST ADVANCED CENTRAL DEVELOPMENT REGION WHILE THE OTHER THREE MORE REMOTE REGIONS COMMAND ONLY 16, 16 AND 15 PERCENT. IN SHORT, AS AT LEAST ONE MEMBER OF THE RASTRIYA PANCHAYAT HAS ALREADY NOTED, THE GOVERNMENT HAS A WAY TO GO IN GETTING FUNDS TO THE POOREST OF THE POOR IN THE REMOTE REGIONS OF THE COUNTRY.
(D) FINALLY, DESPITE THE STATED PRIORITY TO PUT MORE ATTENTION ON DEVELOPMENT EFFORTS THAT WILL IMPACT DIRECTLY ON THE PEOPLE, INFRASTRUCTURE CONTINUES TO COMMAND A LARGE SLICE (38 PERCENT) OF THE PIE. WHILE THE PROJECTED PERCENTAGE INCREASES IN THESE SECTORS OVER THE 1977/78 FIGURES ARE LESS THAN IN OTHER AREAS, IT IS CLEAR THAT THE GOVERNMENT CONTINUES TO HAVE A PROBLEM IN REDIRECTING ITS EFFORTS AWAY FROM MAJOR CAPITAL PROJECTS.

6. THE 20 PERCENT INCREASE IN THE REGULAR BUDGET REFLECTS A SHARP UPSWING FROM THE 9 AND 12 PERCENT FIGURES OF THE PREVIOUS TWO YEARS. HOWEVER, MINISTER THAPA TOOK PAINS TO POINT OUT THAT THIS WAS ACCOUNTED FOR PRIMARILY BY PLANS TO GIVE GOVERNMENT WORKERS A SALARY INCREASE, THE FIRST IN TWO YEARS, RANGING FROM 18 PERCENT AT LOWER GRADES TO JUST UNDER 5 PERCENT AT THE TOP. THE FOLLOWING TABLE GIVES A BREAKDOWN OF THE REGULAR BUDGET BY MAJOR CATEGORIES, AGAIN WITH COMPARISONS TO PREVIOUS YEARS:

1976/77	1977/78	1916/79
(ACTUAL)	(REVISED ESTIMATES)	(ESTIMATES)

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GENERAL ADMINIS-			
TRATION I	147.2	175.3	211.1

ECONOMIC SERVICES	91.0	103.0	106.5
SOCIAL SERVICES	134.3	160.7	182.5
DEFENSE & POLICE	242.0	262.5	291.7
DEBT SERVICING	95.6	123.1	182.3
OTHER	122.0	94.0	130.9
GRAND TOTAL	832.0	918.6	1105.0

IN GENERAL THE REGULAR BUDGET APPEARS QUITE TIGHT. WHILE ALLOCATIONS FOR DEFENSE AND POLICE ARE THE LARGEST SINGLE ITEM (26 PERCENT OF THE TOTAL), WHEN LOOKED AT IN THE CONTEXT OF THE OVERALL BUDGET THEY CONSTITUTE BUT 7.8 PERCENT, A VERY MODEST FIGURE AND ONE DOWN A BIT FROM LAST YEAR'S 8.6. THE OTHER ITEM OF NOTE IS THE SHARP RISE IN DEBT SERVICING COSTS. WHILE THE INCREASE HARDLY REFLECTS A DEBT SERVICING PROBLEM (FOR A LEAST DEVELOPED COUNTRY, NEPAL IS EXTREMELY WELL OFF IN THIS REGARD), IT DOES SIGNAL A COMING TREND AS OLD DEBTS COME DUE AND THE BALAN E IN FOREIGN ASSISTANCE SHIFTS FROM GRANTS TO LOANS.

7. ON THE FINANCING SIDE, FOREIGN ASSISTANCE CONTINUES TO PLAY A DOMINANT ROLE. NOT ONLY ARE THE PROJECTED FIGURES UP SHARPLY (58 PERCENT) BUT FOREIGN ASSISTANCE IS ALSO PROJECTED TO ACCOUNT FOR 58 PERCENT OF THE DEVELOPMENT BUDGET, UP FROM 50 PERCENT IN THE REVISED 77/78 FIGURES. THE IMMEDIATE QUESTION IS WHETHER SUCH ANTICIPATED INCREASES ARE REALISTIC. DOUBTS ARISE NOT OVER THE ISSUE OF AVAILABILITY OF FUNDS, BUT OVER THE MYRIAD OF PROBLEMS INVOLVED IN DISPERSING SUCH LARGE SUMS. THE 73 PERCENT INCREASE IN OUTLAYS FROM 76/77 TO 77/78 IS SEEN BY MANY AS A REMARKABLE ACHIEVEMENT IN ITSELF. TO SUSTAIN SUCH A SHARP UPWARD TREND, EVEN AT A SOMEWHAT REDUCED RATE, IS A GOAL WHICH MAY WELL BE BEYOND NEPAL'S CAPABILITIES AT THIS TIME.

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CORRECTED COPY (TEXT)

8. IF THE MINISTER'S PROJECTIONS ON FOREIGN ASSISTANCE ARE ACHIEVED, THE MAJOR BENEFACTOR WILL BE THE MULTILATERAL DONORS. AS THE FOLLOWING TABLE INDICATES, WHILE BILATERAL ASSISTANCE IS ANTICIPATED TO INCREASE BY 21 PERCENT, LOANS AND GRANTS FROM MULTILATERAL SOURCES REFLECT AN INCREASE OF 112 PERCENT AND WILL CONSTITUTE 55 PERCENT OF ALL FOREIGN ASSISTANCE. THE OTHER INTERESTING POINT IS THE CONTINUING TREND TOWARDS LOANS AS OPPOSED TO GRANTS. WHILE THE REVISED 77/78 FIGURES STILL GIVE A SLIGHT EDGE TO THE LATTER, IT IS LIKELY IN THE COMING YEAR THAT LOANS WILL TAKE THE LEAD TO STAY-- WITH THE IMPACT OF THE MULTILATERAL DONORS AGAIN BEING DECISIVE.

	1976/-	1977/78	1978/79
	(ACTUAL)	(REVISED ESTIMATE)	ENGL (ESTIMATES)
FOREIGN GRANTS	392.6	484.9	718.6
BILATERAL	(344.9)	(417.2)	(561.8)
MULTILATERAL	(47.7)	(67.7)	(165.8)
FOREIGN LOANS	164.3	478.6	# 804.7

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BILATERAL	(26.0)	(150.1)	(122.8)
MULTILATERAL	(138.3)	(328.5)	(682.0)
GRAND TOTAL	556.9	963.4	1523.3

9. BALANCING THIS EMPHASIS ON FOREIGN ASSISTANCE, MINISTER THAPA STRESSED WHAT HE TERMED NEPAL'S CONSIDERABLE ACHIEVEMENTS IN MOBILIZING INTERNAL RESOURCES. HE CITED THE 19 PERCENT INCREASE IN INTERNAL REVENUE FROM THE ACTUAL 76/77 FIGURES TO THE REVISED 77/78 ESTIMATES, A RATE OF INCREASE WHICH HE STATED HAD BEEN MAINTAINED OVER THE PAST SEVERAL YEARS. SET AGAINST THIS ACHIEVEMENT, HOWEVER, IS THE FACT THAT THE INCREASE FELL WELL SHORT OF THE 30.5 PERCENT PROJECTED IN LAST YEAR'S BUDGET, RAISING IMMEDIATE DOUBTS AS TO THE VALIDITY OF THE 28 PERCENT INCREASE CALLED FOR IN THE COMING YEAR. OF THE RS 445.0 MILLION IN PROJECTED NEW REVENUE RS 105 MILLION IS ANTICIPATED FROM NEW OR ALTERED TAXES WHILE THE REMAINDER SHOULD COME FROM NORMAL GROWTH. NEW TAX REVENUES ARE BASED ACCORDING TO THAPA ON PROPOSALS WHICH SEEK (A) TO AVOID ADDING TO BURDENS OF THE COMMON MAN AND (B) BOTH TO PROTECT DOMESTIC INDUSTRY AND STIMULATE EXPORTS. THEY ARE TO INCLUDE

CHANGES IN CUSTOMS DUTIES NETTING RS 25 MILLION; INCREASE IN EXCISE DUTIES TO THE AMOUNT OF RS 30 MILLION; HIGHER INCOME TAXES TOTALING RS 5 MILLION; RS 14 MILLION FROM CHANGES IN THE TAX INSTITUTED LAST YEAR ON COMMERCIAL BANK CREDITS; AND FINALLY AN ADDITIONAL RS 30 MILLION IN TAXES ON LARGER LAND HOLDINGS (ABOVE 4.8 ACRES). WHETHER THESE AMOUNTS ARE ACHIEVEABLE OR EVEN IN ALL CASES CONSISTENT WITH THE STATED OBJECTIVES IS ANOTHER QUESTION. SIMILARLY THE GROWTH PROJECTIONS ARE ALSO SUBJECT TO CHALLENGE. FOR EXAMPLE, CUSTOMS RECEIPTS APPEAR TO BE BASED ON THE FREE APPLICATION OF THE NEW TRADE POLICIES. BUT BOTH THE ANTI-SMUGGLING PROVISIONS OF THE TRADE AND TRANSIT LIMITED OFFICIAL USE

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AGREEMENT WITH INDIA AS WELL AS CONCERN OVER A GROWING TRADE IMBALANCE MAY FORCE FIGHTENING OF THESE POLICIES BEFORE THE YEAR IS OUT. THE FOLLOWING TABLE GIVES A BREAKDOWN BY MAJOR CATEGORIES OF THE ANTICIPATED SOURCES OF INTERNAL REVENUE. COMPARISONS ARE LIMITED TO THE CURRENT YEAR'S REVISED ESTIMATES DUE TO CHANGES IN THE REVENUE CLASSIFICATION SYSTEM.

	1977/78 (REVISED ESTIMATES)	1978/79 (ESTIMATES)
TAX REVENUE	1240.6	1670.7
CUSTOMS	(460.6)	(648.9)
EXCISE	(480.1)	(618.0)
LAND TAX	(143.5)	(191.7)
INCOME & PROPERTY	(156.4)	* (212.1)
NON-TAX REVENUE	340.0	354.8
GOODS & SERVICES	(163.9)	(142.2)
DIVIDENDS, INTEREST & LOAN RECOVERIES	(104.8)	(133.4)
OTHER	(71.3)	(79.2)

10. DOUBTS ABOUT BOTH FOREIGN AID AND INTERNAL REVENUES RAISE THE POSSIBILITY OF A CONSIDERABLY LARGER BUDGET DEFICIT THAN PROJECTED XZ THE GOVERNMENT. THIS IN TURN

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C O R R E C T E D C O P Y (TEXT)

PUTS TO QUESTION THE MINISTER'S STATED INTENTION TO HOLD DOWN GOVERNMENT DOMESTIC BORROWING IN AN EFFORT TO CONTAIN INCREASES IN MONEY SUPPLY AND HENCE INFLATIONARY PRESSURES. QUITE THS CONTRARY--IT SEEMS LIKELY THAT EITHER GOVERNMENT BORROWING WILL GO UP SUBSTANTIALLY OR EXPENDITURES, MOST PROBABLY IN THE DEVELOPMENT SECTOR, WILL HAVE TO BE CUT BACK. NEITHER ALTERNATIVE IS ATTRACTIVE.

11. BEGIN LOU. COMMENT: THE BUDGET PROPOSAL STRIKES US AS OVERLY OPTIMISTIC ON ITEMS OF EXPENDITURE AND LOCKING IN REALISM AS TO AVAILABLE FINANCING. THIS IS PARTICULARLY TRUE WHEN IT IS SET AGAINST THE ECONOMIC SURVEY FOR 1977/78 WHICH THE MINISTER HAD PRESENTED TO THE RASTRIYA PANCHAYAT ONLY TWO DAYS BEFORE. THE SURVEY REPORTED FACTUALLY ON DEVELOPMENTS IN THE VARIOUS SECTORS AND THE OVERALL IMPRESSION WAS OF AN ECONOMY FACING SERIOUS PROBLEMS--DECLINING FOOD GRAIN PRODUCTION, INDUWLRIAL STAGNATION, GROWING TRADE IMBALANCE, SERIOUS PROBLEMS IN THE INDIAN RUPEE ACCOUNT, TO NAME BUT A FEW. BUT TWO DAYS LIMITED OFFICIAL USE

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LATER THE BUDGET MESSAGE SPEAKS OF SUCCESS IN IMPLEMENTING DEVELOPMENT PLANS, WHEN IT IS SPECIFICALLY IN THOSE SECTORS WHERE THE LARGEST PROBLEMS EXIST THAT IMPLEMENTATION WAS MOST UNEVEN. AND WHEN THE BUDGET PROJECTS FUTURE PLANS TO REVERSE THIS TREND, IT BASES THESE EFFORTS ON THIS GAME--STRESS THE ACHIEVEMENTS, DOWNPLAY THE FAILURES--ONE MIGHT HAVE HOPED FOR A MORE HARD HITTING, REALISTIC BUDGET MESSAGE. CERTAINLY THE ISSUES WHICH THAPA HAS DUCKED ON THIS OCCASION CANNOT BE AVOIDED FOR LONG. IT WILL BE INTERESTING TO OBSERVE THE ADJUSTMENTS THE GOVERNMENT MAKES DURING THE YEAR AS THESE REALITIES

MAKE THEMSELVES FELT. END LOU.
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